QCOSS Queensland Council of Social Service

Submission to QCA Interim Consultation Paper on Regulated Retail Electricity Prices 2016-17

About us

The Queensland Council of Social Service (QCOSS) is Queensland's leading force for social change, working to eliminate poverty and disadvantage. With more than 600 members, QCOSS undertakes informed advocacy and supports a strong community service sector in Queensland. QCOSS focuses on providing effective policy advice, working to strengthen responsive community services and having productive partnerships with government, private sector and the community sector. This work is done with a Queensland free of poverty and disadvantage front of mind.

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Context

Thank you for the opportunity to provide a submission to the Interim Consultation Paper on Regulated Retail Electricity Prices for 2016-17. This is an important consultation as the Queensland Competition Authority (QCA) is setting regulated electricity prices for regional Queensland as electricity price regulation in South East Queensland (SEQ) is expected to cease from 1 July 2016. This submission is therefore made on the understanding that the notified prices will only apply in the Ergon Distribution area in 2016-17.

We appreciate that the Interim Consultation Paper essentially sets out the QCA's intended approach to setting prices and calls for feedback on the different aspects of this approach. We have provided a number of comments later in this submission relating to the approach. We believe however that it is important for the QCA to have an understanding of the circumstances facing regional electricity customers and that these be considered by the QCA when making decisions that will impact the prices that will apply to these customers.

Regional Queensland is more disadvantaged economically and socially than SEQ and it is arguable that the gap has been widening in recent years. This is evident in the very recent Queensland Regional Profile Report[1] from Queensland Treasury. For example, a comparison of the population by the index of relative socio-economic disadvantage revealed in 2011 that the Greater Brisbane area had 16.2 per cent of people in the most disadvantaged quintile (lowest quintile), while the rest of Queensland had 23.5 per cent. Such relative differences are not surprising when it is considered that median total personal income tend to be higher in the Greater Brisbane area, for example, in 2011 the income for the former area was $633 per person while it was $553 in the rest of

[1] Queensland Government Statistician's Office (2016), Queensland Regional Profiles: Resident Profile. Greater Brisbane compared with rest of Queensland.

Queensland. Unemployment is also higher outside of the Greater Brisbane area, consider for the September quarter 2015, the rate for the Greater Brisbane area was 5.9 per cent while it was 7 per cent for the rest of Queensland. Regional Queensland also has a higher proportion of its population on Centrelink concessions than in SEQ with 7.3 per cent of the regional population with Centrelink healthcards as opposed to 6.3 per cent of the population in SEQ. .

It follows therefore that there is a greater incidence of energy hardship in regional Queensland. The QCA's own statistics released on disconnection for non-payment and hardship program participation show an increasing trend of electricity debt being managed through hardship policies and growing disconnection for non-payment in regional Queensland.[2] In 2014-15, 29,692 households across the state were disconnected for non-payment, which is the highest ever recorded in Queensland and represents almost double the disconnections recorded in 2008-09. Of this number almost 44 per cent were in Ergon's distribution area even though regional Queensland accounts for only 30 per cent of the population. There are significant social and economic flow-on impacts of disconnection on families and individuals as set out in various reports.[3]

We raise this as context for the QCA to consider in this process to highlight that it is critically important that prices rises for regional customers are minimised to the greatest extent possible. The current QCA determination – including decisions around the approach to the application of the Uniform Tariff Policy (UTP), decisions around tariff structures, approaches to the efficient retail operating costs (ROC) and retail margins - all have an impact on the affordability of electricity for regional households. Given that retail prices have increased significantly over recent years, and that this has occurred at the same time as significant increases in the number of households disconnected for non-payment, the QCA must actively seek to ensure that changes to the approach and methodology do not introduce any new upward pressures on prices in 2016-17. QCOSS will advocate strongly in response to the Draft Determination should any positions result in an overall increase in notified prices for 2016-17.

Overall approach – headroom and competition

In order to apply the Uniform Tariff Policy (UTP), QCOSS understands that the QCA intends to continue to base its framework for setting notified prices for regional customers on a "representative retailer" operating in SEQ. The QCA's approach, consistent with previous years, and in the absence of observable information about the standing offer prices that will apply in SEQ in 2016-17, is to add a standing offer "headroom" (previously this was up to 5 per cent to the total costs of supply as assessed for a representative retailer in SEQ) to estimates of energy, network and retail costs. Headroom was in addition to a retail margin which last year was 5.7 per cent.

As set out in the covering letter to the current delegation from the Queensland Government, the QCA is required to come up with standing offer price for a "representative retailer" in SEQ as a basis for setting regional prices. The covering letter to the delegation on 30 November 2015 says that prices for small customers in regional Queensland should broadly reflect the expected prices for customers on "standing offers" in SEQ. Indeed the letter sets the expectation that the QCA's approach to the notified prices for 2016-17 "*reflect a consistent approach to my delegation for 2015-16*".

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[2] QCA, June 2015. Small Customer Disconnection, Hardship and Complaint Statistics. www.qca.org.au/Electricity/Reviews/Market-reports-and-statistics
[3] Public Interest Advocacy Centre, April 2013. Cut Off III: The Social Impact of Utility Disconnection. www.piac.asn.au/publication/2013/04/cut-iii
Consumer Action Law Centre, August 2015. Heat or Eat. http://consumeraction.org.au/wp-content/uploads/2015/08/Heat-or-Eat-Consumer-Action-Law-Centre.pdf

QCOSS maintains our previous position in disagreeing with the intent of the Minister's covering letter. The application of the UTP is best implemented by ensuring that the market offers available in SEQ form part of the QCA's consideration of the efficient costs of supply and not be based solely on "standing offers". This is because a range of prices is currently available to SEQ customers of which standing offer prices are likely to be at the top of this range. Standing offers may not be reflective of efficient costs as retailers use these offers as the default contract against which more generous discounted market products can be compared. Depending on the strategy implemented by a retailer, standing offer prices may be set at higher than efficient costs in order to promote a larger discount on market offers.

QCOSS continues to question whether "headroom" is appropriate. QCOSS' view is that headroom is in reality no more than an additional retail margin. For 2015-16 prices, once headroom was applied across all other costs (including the "designated" retail margin of 5.7 per cent), the effective level of margin above the costs of supply was higher than 11 per cent. In our view "headroom" is not an allowance for the extra costs of doing business in a competitive market. Such costs are accounted for by customer acquisition and retention costs (CARC). We do not agree that it is fair to charge regional Queenslanders for this additional "margin".

A legitimate and more accurate reflection of the UTP would be for the QCA to adopt a position that would result in setting prices somewhere between market prices and standing offer prices, to reflect the average price paid by SEQ consumers. QCOSS is concerned that price deregulation will lead to higher retail margins associated with standing offer prices, as appears to have occurred in other states according to recent reports by St Vincent de Paul Society and Brotherhood of St Lawrence.[4] This may then lead to a higher "headroom" associated with the standing offers for a "representative retailer" in SEQ, and thus impact customers on the regulated rate in regional Queensland.

The QCA previously has argued that adopting QCOSS' position on this point could result in customers in regional Queensland paying prices 'even further below cost'. However QCOSS submits that this is not relevant to the application of the UTP and the QCA's role in setting notified prices. The purpose of the UTP is to ensure consistency with prices paid in SEQ, not to minimise the extent of the differential between real costs of electricity in regional Queensland versus the costs actually paid by customers in regional Queensland. That is a separate policy issue and is not included in the delegation.

In QCOSS' view there is more work required to clearly justify the continued use of headroom and to calculate it on an equitable basis in keeping with the intent of the UTP. QCOSS' position remains that there is little justification for the inclusion of headroom in regional notified prices and if it is to be included it should be a relatively small rate above the "efficient" retail margin.

Network costs

Overall, QCOSS continues to support the QCA's application of the UTP to network costs by basing notified prices for residential customers in regional areas on SEQ cost levels. This means that the QCA will use Energex price levels.

QCOSS also supports the QCA's use of the existing Energex tariff structure for Tariff 11 for 2016-17 prices because:

[4] St Vincent de Paul Society, September 2015. The NEM – still winging it. www.vinnies.org.au/icms_docs/228265_National_Energy_Market_-_Still_Winging_It.pdf. P5. Brotherhood of St Laurence, July 2015. Rising retail costs and their impact on energy affordability. http://library.bsl.org.au/jspui/handle/1/6112

- Using Ergon network tariff structure – which is an inclining block tariff – would be very confusing for customers and would constitute a major change of tariff structure. Any changes like this should be accompanied by an education and public awareness campaign. The need for proactive public communication of changes in tariff structure has been highlighted by the negative customer response to the transition of Tariff 11 to 'cost reflectivity' over the previous three years which was undertaken with no public awareness or education and has had significant financial impacts on many households.
- Introducing an inclining block tariff structure now, particularly if combined with a public education campaign which we believe would be essential to avoiding customer detriment, is likely to create customer confusion and may make the task more difficult in the future when another tariff structure with some demand component is introduced.
- Energex's fixed charge is significantly less than Ergon's and so relatively smaller users would be still worse off, even though they may benefit from a relatively lower first block (relative to Energex structure).

Energy costs

QCOSS has commented in its previous submissions to the QCA on the different components relating to energy costs and in general has supported the QCA's approach. We refer the QCA to our previous submissions and would like to make the following additional comments to the QCA on its current approach:

- Load control tariffs – Tariff 31 and 33 are important tariffs for assisting people to manage load and affordability. QCOSS would be especially keen to understand the drivers of wholesale costs for these tariffs and asks that this is explicitly addressed in the draft determination given the widespread uptake of these tariffs in Queensland.
- Prudential capital costs – for the 2015-16 Final Determination the QCA accepted that these costs are part of Retail Operating Costs (ROC) however it is noted in the Interim Consultation Paper that for 2016-17 determination the QCA is seeking feedback on whether to separate these again and include them as energy costs. QCOSS' main concern (as stated in previous submissions) is that as the QCA was using IPART's general retail costs in its benchmarking, by separately itemising the costs of meeting Australian Energy Market Operator (AEMO) prudential costs, QCA was double counting the same costs. This year, the QCA is proposing a different approach to setting an efficient ROC which includes a bottom-up approach as well as a benchmark one. Consistent with our previous positions, QCOSS' view remains that the QCA can legitimately separately itemise these costs in energy costs as long as these costs are removed from the general retail costs. It is assumed that this will be more transparent this year with the new approach.

Retail costs

QCOSS supports the QCA in seeking to undertake a more comprehensive assessment to establish efficient ROC and efficient retail margin. It is timely to undertake a more thorough assessment of these costs as the QCA had previously used a 2013 IPART estimate as the benchmark. The Victorian market has been deregulated since 2009 and prices in NSW and South Australia have been deregulated more recently. Tariffs and retailers' cost structures will have changed since 2013 as retail markets become more mature.

For the 2016-17 determination, the QCA has asked ACIL Allen to estimate efficient ROC and retail margin components. Their methodology is set out in their paper and they are proposing a combination of "bottom up" and benchmarking approaches. QCOSS notes that this is similar to the approach favoured by the AEMC in its 2013 paper on a best practice price methodology. The ACIL reports also refers to a third approach called the “expected returns” approach identified by AEMC to estimate retail margin, but this is not taken forward by ACIL.

Given the importance of undertaking a more comprehensive review and the introduction of a new methodology, it is regrettable that much of the consultation period for the Interim Consultation Paper was over the Summer holiday period. It is expected however that the QCA will publish the full results of the ACIL Allen assessment with the Draft Determination. This will allow for potentially more in depth analysis and greater understanding of the approach and its results.

There is no indication at this stage what the quantum of retail costs will be from this new approach and what impact they will have on the regulated retail prices. The benchmarking component of the new approach to estimate the ROC and retail margin includes a range of tariffs from both market and standing offers across the National Energy Market (NEM). QCOSS would be concerned if the ROC and retail margins resulting from the ACIL Allen assessment end up being greater than in previous years. Recent research (as per footnote 4), has revealed that the retail component in a typical bill on a standing offer in the Victorian distribution areas was much higher than in the Energex area. In the Victoria areas the retail component was up to about 30 per cent of the total bill, while in Energex’s area it was about 16 per cent. Given that both energy and network prices are relatively high in Queensland to the rest of the NEM, QCOSS is concerned that the cost stack approach could therefore produce high notified prices for regional Queensland.

Iit will be especially important for ACIL Allen to take into account where there are differences in the energy markets across jurisdictions that might impact ROCs and margins. For example, the Victorian retail energy market differs from the rest of the NEM where the National Energy Customer Framework (NECF) operates and where there are schemes which may increase operating costs (such as costs associated with smart meters) which applies to retailers in Victoria only). As indicated in its paper these will be identified and captured in the analysis by ACIL Allen

The bottom up analysis is very important and likely to provide a key input to the task, given that benchmarking will not differentiate ROC from the retail margin The bottom up approach relies on obtaining a large amount of detailed data from retailers in a short period of time. As far as can be ascertained, retailers have no obligation to provide that data to the QCA, and any data provided will be unaudited for accuracy. It is QCOSS’ view that the QCA or ACIL Allen should also attempt to verify the costs derived in the bottom up analysis independently of retailers, as a way of demonstrating and providing confidence that the estimates of the ROC and retail margins are robust.
In general, we would expect that if the benefits of retail deregulation are being realised by consumers in other states, that this would be reflected in the QCA setting lower ROC and retail components when using this approach and hence with price deregulation coming into SEQ that this is also reflected in the prices for a “representative retailer” in SEQ. Any other result could be seen to suggest a failure of price deregulation to improve efficiency and competition.

QCOSS welcomes the QCA’s discussion on how to update the ROC in its Interim Consultation Paper. QCOSS agrees that that there should be some factor built into this exercise that takes into account that retailers will become more competitive over time, and hence more efficient, which should result in a real decrease over time, rather than an escalation (all other things constant). It is acknowledged that at some stage in the future a further assessment of the ROC and retail margin will need to be conducted. The timing of this will depend on how quickly the SEQ market becomes more competitive and the extent to which the costs identified in this Determination diverge from those of a representative retailer in SEQ.